CITATIONS

CITATIONS (Continued)

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM 1970

No. 883

UNITED STATES OF AMERICA,
Petitioner,
versus
EDNA GENERES, Wife of, and ALLEN H. GENERES,
Respondents.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR RESPONDENTS

QUESTIONS PRESENTED

The "Question Presented" is whether taxpayer's loss, which resulted from his agreement to indemnify a bonding company's guarantee of the work of the construction company in which taxpayer was employed as a salaried officer and was a shareholder, was "proximately related" to taxpayer's trade or business as corporate officer so that the loss was deductible as

a business bad debt under Internal Revenue Code § 166 (1954).[1]

STATEMENT

The facts set forth in Petitioner's brief are essentially accurate, but the "Statement" requires amplification. To supplement those facts for a better understanding of this case, it must be emphasized that there were several shareholders of Kelly-Generes Construction Company, Inc. (Kelly-Generes). Allen Generes himself owned only 44% of the stock, and was not a majority shareholder. His son-in-law, William F. Kelly, also owned 44%. Both men were officers of the cor-

---

[1]Respondent respectfully submits that the "Questions Presented", as stated by Petitioner, omits important issues of the case, and takes one slice of the problem, lifting it out of context. To the extent that the "Questions Presented" in Petitioner's brief formed an important part of the trial judge's charge to the jury, they are correct. But in a larger sense they are misleading. The question that the jury had to decide was whether the bad debt involved in this case should be characterized as a "business bad debt" or as a "nonbusiness bad debt." Under the terms of the Commissioner's own Regulations, a debt is deductible as a business bad debt if the loss resulting from the debt's becoming worthless bears a relation to the trade or business of the taxpayer which is *"proximate."* Fed. Tax Regs. § 1.166-5(b)(2). In the present case, the jury was asked to decide whether the taxpayer's signing of the indemnity agreement with Maryland was *proximately* related to his trade or business of being an employee of the company. Petitioner has selected only one of several indicia that the trial judge charged the jury to consider in determining whether there was a sufficient relationship between the trade or business of being a corporate employee and the act of signing the blanket indemnity agreement, so that the bad debt resulting therefrom should be considered a business bad debt. The "Questions Presented" as phrased by the government bear, then, upon the broader question as Respondent submits it.

poration; both men rendered services to the corporation; and both men received salaries from the corporation.

Generes began work in the construction business as a young man in the early part of this century. In the 1940's he formed a partnership with his son-in-law, William F. Kelly, who also was in the construction business (but a separate and distinct business from his father-in-law's). Obviously, Generes had many more years of experience than his son-in-law, and his experience proved very valuable to the business. The partnership prospered, and in 1954 it was incorporated as Kelly-Generes Construction Co., Inc. The corporation, too, prospered and operated successfully for many years.

Drawing on his years of experience in the contracting business, Generes performed significant counseling services by reviewing bids and jobs which the company proposed to undertake. His advice was useful in readjusting bids to be made, in formulating cost estimates and feasibility projections, in determining whether to accept certain jobs, and so forth. In addition, Generes helped obtain necessary financing and bonds for the corporation. This latter work included obtaining bank loans (which loans are not at issue here). What is relevant to the instant case is that Generes assisted in obtaining payment and performance bonds, which are absolutely essential in the contracting business, an obviously unique business enterprise.

Generes's son-in-law, Kelly, performed completely different services; he worked in the field and handled the day-to-day problems of actual construction work, for which he was paid an annual salary of $15,000. Generes, who had only a $38,900 investment in the corporation, received a salary of $12,000 per year. As shown above and clearly outlined in the trial testimony, Generes rendered numerous and valuable services for this salary. R. 44-46.* Thus, neither of these men was a majority shareholder; each man rendered different and valuable services to the corporation; and both men received different salaries from the corporation.[a] But both men had the same investment interest in the corporation, $38,900.

Petitioner's "Statement" contains no reference to the testimony in the trial court concerning the unique nature of the contracting business and the essential role of payment and performance bonds for the corporation. Kelly-Generes engaged in heavy construction work for various governmental authorities, and the undisputed testimony, accepted by the government at the trial as a "fact of life in the construction business", is that a construction business of this nature simply cannot operate without the use of bonding companies, and that bonding companies will not issue pay-

*"R." refers to separately-bound record appendix.

[a]Despite inferences in Petitioner's Brief regarding the significance of the family relationships, there is no evidence in the record that the family relationship played any role in the business. The two men had different backgrounds and different business experience, which combined to produce an advantageous and profitable, but arms-length, working arrangement for many years.

ment and performance bonds without the endorsement of the corporate officers.[3] In other words, the unique nature of the construction industry — a factual matter — is an aspect of this case which cannot be ignored. It bears heavily on Generes's motivation, and it demonstrates the nexus between the execution of the indemnity agreement and the taxpayer's trade or business.

In consideration for Maryland Casualty Company's agreement to furnish payment and performance bonds for Kelly-Generes as required by its construction contracts, both Kelly and Generes agreed personally to reimburse Maryland in the event that it had to fulfill its bonding promise and in the further event that Kelly-Generes (the corporation) could not indemnify Maryland. For many years these indemnity agreements were executed on an *ad hoc* basis, with separate indemnity agreements executed in favor of Maryland for each bond issued by that company for a job being or to be performed by Kelly-Generes. In December of 1958, the parties decided to execute a "blanket indemnity agreement" in lieu of signing a separate indemnity agreement for each construction job. The corporation executed the document as applicant, and

---

[3]The trial attorney for the Government acknowledged this fact: "We don't have any quarrel with [the fact] . . . that Kelly-Generes Construction Company needs bonds to get construction jobs. This is — this is just a fact of life in the construction business." R. 35. See also: R. 41, 85-86. Corroborating the testimony of both Generes and Kelly, the testimony of an insurance agent, Mr. Durel Black (R. 74-79), was elicited in support of this proposition, and the testimony of Mr. Kemp Cathcart, a former Vice-President of Maryland Casualty Company (R. 83-86), was elicited in support of this "fact of life."

Generes and Kelly signed it individually as indemnitors. Under this agreement they agreed to hold Maryland harmless from any loss sustained as a result of its bonding the construction jobs of Kelly-Generes. At the same time, Maryland agreed to increase the line of surety credit of Kelly-Generes from approximately $1,000,000 to $1,500,000 for any one job and to a total credit line of $2,000,000 inclusive of all jobs bonded by them. This did not mean that Generes actually exposed himself to $2,000,000 of personal liability: the indemnity obligation to repay would arise only if the funds from the contract (which would include stage payments and retainage) were insufficient and if Kelly-Generes itself could not repay the differential. Thus, there were substantial assets to be retrieved before any obligation could ever arise for Generes to indemnify Maryland. The $2,000,000 line of credit meant that Kelly-Generes could enter into construction contracts for which the aggregated contract price was $2,000,000. There would be money in the contract to pay the contractor, and Generes would be liable only if the company defaulted on the job and was unable to pay *and* if there was insufficient retainage in the contract job, and then only for the differential (the amount ultimately uncollectible from the corporation). The $2 million exposure, then, was vastly different from the exaggerated risk that the government makes it out to be in Petitioner's Brief.

In 1962 Kelly-Generes seriously under-bid two important projects and defaulted in the performance of its contracts. Maryland completed the jobs, and then sought enforcement of the indemnity agreement a-

gainst Generes and Kelly. Generes paid $162,104.57 to Maryland, and since he was unable to collect that amount from the company as a subrogated creditor, he claimed the payment as a business bad debt.

SUMMARY OF ARGUMENT

The issue here is whether the trial judge's charge to the jury stated the proper standard for determining whether the debt incurred by Allen H. Generes was "proximately related" to his trade or business of being a corporate officer of Kelly-Generes Construction Company. The trial judge, the Honorable Alvin B. Rubin, who is one of the most respected authorities in the nation on tax law, charged the jury that "a debt is proximately related to the taxpayer's trade or business when its creation was significantly motivated by the taxpayer's trade or business, and it is not rendered a non-business bad debt merely because there was a non-qualifying motive as well, even though the non-qualifying motive was the primary one." The test employed by Judge Rubin tracks the language of the majority decision of the Second Circuit Court of Appeals in *Weddle v. Commissioner*, 325 F.2d 849 (2 Cir. 1963). The majority of the panel of the Fifth Circuit Court of Appeals which heard the instant case agreed with the majority holding in the Second Circuit decision.

Counsel respectfully submits that the test employed by these jurists is consonant with the change in the law from the Internal Revenue Code of 1939 to the Internal Revenue Code of 1954, and is consonant with

the language of the statutes that are applicable (in other words, with the statutory history as well as with what the present statute in fact says); that the test which they have adopted and which they followed here commends itself to common sense, recognizing as it does that a person may have more than one motivation for an action, and in particular that the question is one of fact to be determined in each particular case, and most importantly, it sets forth a rational guideline that distinguishes motivations that are important from motivations that are indirect, remote or speculative.

In cases involving shareholder-employees, the taxpayer occupies a dual role; the trier of facts must simply determine which role the taxpayer occupied with regard to the transaction giving rise to the loss. In consonance with the language of the statute as well as the statutory history and in consonance with the language of the Regulations, the "significant motivation" test in such a case is absolutely sound and proper. Under this test, even where a taxpayer's investment in his corporation has substantial value, the protection of such investment cannot be assumed to be "the only significant motivation" for his loans or guarantees. By the same token, it does not follow from the fact that an employee happens to hold an investment interest in his corporate employer that loans made by him were not actuated by the desire to protect his employment. The concept of "significant motivation" is eminently reasonable: whether a debt has a business nexus will no longer be decided by looking at only one of the taxpayer's motives. The courts,

and the juries, will be required rather to consider all of the ends being served, to determine which of these were "significant," *i.e.,* which played a substantial part, a material part, a considerable part, in the transaction, and to measure the significant motives against the standards for deductibility.

ARGUMENT

As stated above, the "Questions Presented' concern the appropriate standard to apply in determining the propriety of certain business bad debt deductions. This involves a very narrow class of bad debts, namely, a certain kind of loss where the taxpayer happens to be both a shareholder and an employee of a corporation. It is not disputed here, and the government conceded at the trial, that being an officer of a corporation (here, Allen H. Genere's being president of the Kelly-Generes Construction Company) does constitute a trade or business.[4] The essential problem is to determine whether the taxpayer's loss was so related to that trade or business that it gave rise to a business bad debt (as opposed to a nonbusiness bad debt) within the meaning of Internal Revenue Code § 166.

---

[4]The fact that Generes had another trade or business, for which he also received a salary, does not have any relevancy here, as the government also does not dispute that a taxpayer may have more than one trade or business, and that Generes did have the trade or business of being a corporate executive for Kelly-Generes. R. 35.

I.

The "Significant Motivation" Standard Is Compatible With The Statute, The Commissioner's Regulations And The Principles Announced By This Court In Whipple

A. *The statutory history and the language of the present statute do not support Petitioner's restrictive interpretation.*

To understand the problem, it is necessary to consider not only the relevant sections of the present Internal Revenue Code and the relevant Treasury Regulations, but also the predecessor statute. Prior to the adoption of the Internal Revenue Code of 1954, business debts were defined in Section 23(k)(4) of the Internal Revenue Code of 1939 to mean ". . . a debt the loss from the worthlessness of which *is incurred in* the taxpayer's trade or business" (emphasis added). This narrow definition required, obviously, a direct relationship between the *debt* and the *business*, because the debt had to be *incurred in* the business.

Congress retained the definition of Section 23(k)(4) of the 1939 Code for purposes of Section 166(d)(2)(B) of the Internal Revenue Code of 1954, so that, as before, an individual may deduct any bad debt loss sustained by him which *is incurred in* a trade or business.

But in addition, the definition of the term "business bad debt" was clearly expanded in Section 166(d)(2)(A) of the 1954 Code to include a debt which is "*created*

or acquired (as the case may be) ***in connection with a*** trade or business of the taxpayer" (emphasis added). In view of the new provision adopted in the 1954 Code, a deduction for a bad debt may properly be claimed by a taxpayer as a business bad debt whether or not the debt is *directly* related to his trade or business, *if* it was *created* or *acquired in connection with* a trade or business of the taxpayer.

On the other hand, a business loss under Section 165(c)(1) must have a much more *direct* relationship to the trade or business of the taxpayer, as the statute specifically refers only to such loss as having been "incurred in" the taxpayer's trade or business. This is not true for "business bad debts." The statutory definition of "business bad debts" does *not* require the same directness, the same proximity, as it does for a loss in the trade or business. Thus, the statute provides that the debt may be "created or acquired (as the case may be)", so that consideration must be given to what is meant by "created" and what is meant by "acquired." Equally important, the "business bad debt" category contains statutory language that differs from the "incurred in" language of the business loss category by referring to the debt's being created or acquired "*in connection with* a trade or business."

The difference between Section 165 (business losses) and Section 166 (bad debts) is not only patent from a simple comparison of the language of the two sections, but it is further demonstrated by the fact that Section 166 contains two separate definitions of "business bad debt." The first definition in Section 166 on bad debts

refers to the debt's being created or acquired *in connection with* a trade or business; the second definition refers to the debt "the loss from the worthlessness of which *is incurred in* the taxpayer's trade or business." These distinctions are critical as a backdrop to understanding this litigation, and they illustrate the error in Petitioner's contentions that rules under Section 165 should apply to Section 166.

In amplification of the above statutes, the Commissioner issued Regulations, which provide that a debt is deductible as a business bad debt if *the relation* which the loss resulting from the debt's becoming worthless bears to the trade or business of the taxpayer is "*proximate.*" Fed. Tax Regs. § 1.166-5(b)(2). This Court indicated its approval of the "proximate relationship" test in *Whipple v. Commissioner*, 373 U.S. 193 (1963). In vacating and remanding *Whipple* to the Tax Court for a determination of whether a taxpayer's loan was made in his business of being a landlord, this Court noted:

> Moreover, there is no proof (which might be difficult to furnish where the taxpayer is the sole or dominant stockholder) that the loan was necessary to keep his job *or was otherwise proximately related* to maintaining his trade or business as an employee.

373 U.S. at 204 (emphasis added).

In the instant case, consonant with the statute and with the Commissioner's own Regulations, the sole

interrogatory submitted to the jury was phrased in terms of "proximate relationship." The interrogatory (R. 115, 162) was as follows:

> Do you find from a preponderance of the evidence that the signing of the blanket indemnity agreement by Mr. Generes was proximately related to his trade or business of being an employee of the Kelly-Generes Construction Company?

In charging the jury, the trial judge instructed them that "[a] debt is proximately related to the taxpayer's trade or business when its creation was significantly motivated by the taxpayer's trade or business, and it is not rendered a non-business debt merely because there was a non-qualifying motivation as well, even though the non-qualifying motivation was the primary one." R. 119.

In a case factually similar to the instant one, *Lundgren v. Commissioner*, 376 F. 2d 623 (9 Cir. 1967), the Court of Appeals for the Ninth Circuit held that the taxpayer was entitled to a deduction for a business bad debt under Section 166 when loans that he made to a corporation in which he was a stockholder became worthless. As here, the taxpayer in *Lundgren* was in a trade or business with respect to his managerial and other services rendered to the corporation. Since his corporation had been unable to obtain loans from banks, it had sought a loan from the United States Small Business Administration, which agreed to advance the funds to the corporation upon condition

that the taxpayer act as guarantor and advance an additional $145,000 of his own money. The corporation had financial difficulties and its facilities were ultimately destroyed by fire. The taxpayer sustained losses to the extent of $129,000. After holding that the taxpayer was in the trade or business of rendering managerial and other services to the corporation, the Ninth Circuit went on to hold that "the debt involved here bore that proximate relationship to this trade or business which satisfies the 'in connection with' requirement" of Section 166 (376 F.2d at 628). The court reasoned:

> Rush More's [the corporation's] existence depended upon its ability to obtain the financing necessary to put its South Dakota operations under way. If the SBA loan had not gone through, the corporation — and petitioner's [the taxpayer's] job with it — would have been finished. In a direct sense, therefore, the advances were related to petitioner's trade or business activities in connection with Rush More. See *Weddle v. CIR*, 325 F.2d 849, 851 (CA 2, 1963).

376 F.2d at 628. In a footnote to the quoted language, the court found it unnecessary to remand to the lower tribunal, "because any conclusion other than that which we have reached here would be clearly erroneous." *Id.* at n.2.

In the instant case it is not disputed that Generes's trade or business was that of working as an executive

and employee of the corporation. *Lundgren* clearly demonstrates the propriety and workability of the test of proximate relationship. If the taxpayer there came under Section 166, so should the taxpayer in the instant case. Just as financing was essential to the continued existence of the corporation in *Lundgren,* bonding was essential to the continued operation of the Kelly-Generes Construction Company. A construction company cannot operate unless it secures bonds, and bonding companies will not issue their bonds unless the substantial officers of the bonded corporation (here, Generes) agree to personally indemnify the bonding company. If Generes had not agreed to indemnify the bonding company, the Kelly-Generes Construction Company — and Generes's job with it — would have been finished, just as was the case in *Lundgren.* And there is even *more* reason to apply Section 166 in the instant case than there was in *Lundgren,* since Generes owned only 44% of the Kelly-Generes stock, while the taxpayer in *Lundgren* owned 59.6% of his corporation's stock (376 F.2d at 625). The *Lundgren* taxpayer was a *majority* shareholder, but the court nevertheless found that his advancements were proximately related to his trade or business of rendering services to the corporation, rather than to his investment in the corporation. Similarly, Generes's agreement to indemnify the bonding company was proximately related to his trade or business of being a corporate executive and employee. This is especially clear when one realizes that he was not a majority shareholder, and that his investment interest was substantially less than the taxpayer's in *Lundgren.*

B. *The logical and necessary import of Section 166, the Treasury Regulations, and Whipple does not require adoption of the "dominant motivation" standard.*

The only real question in the instant case is whether there was a "proximate connection" between the indemnity agreement executed by Generes and his acknowledged trade or business as an officer of the corporation, Kelly-Generes. This Court, in *Whipple v. Commissioner*, 373 U.S. 193 (1963), observed that where "the taxpayer demonstrates an independent trade or business of his own, care must be taken to distinguish bad debt losses arising from his own business and those actually arising from *activities peculiar to an investor* concerned with, and participating in, the conduct of the corporate business." 373 U.S. at 202 (emphasis added).

Thus, it would seem that a taxpayer having both business and investment motivations should be entitled to a business bad debt deduction for losses arising out of transactions which are not "peculiar to" investment. This standard is undoubtedly met where the taxpayer shows that the transaction generating the loss was significantly motivated by business considerations. In no way does it appear that in such a situation the establishment of a proximate connection, required by the statute and the regulations, should depend on showing that the transaction leading to the loss was *primarily* motivated by the trade or business.

Petitioner argues that the dominant motivation test is required because it is the only test that will "inject sufficient certainty" into the interpretation of Section 166. While certainty is a laudable aim in interpreting the tax laws, Respondent respectfully submits that this Court should not sacrifice fairness to the taxpayer in order to achieve certainty. The significant motivation test, while more flexible, presents no extraordinary difficulties in application. But what is more important, nothing in the statute or the regulations appears to compel adoption of the primary motivation rule. Neither the language of the statute, nor the language of the regulations, which collectively refer to debts "in connection with", "incurred in" and in "proximate" relation to the taxpayer's business, can fairly be said to require that the taxpayer show a primary or dominant business or employment motivation. The import of the language is that both business or employment *and* investment motivations may be present in a transaction without one negating the connection of the transaction with the other, and consequently that the taxpayer need show only a *significant* rather than a *primary* business motivation in order to deduct a business bad debt.

While this Court has not ruled on the precise question here presented, the language in *Whipple, supra,* impliedly requires proof only that a debt be "proximately related" to the maintenance of a taxpayer's trade in order that a deduction be allowed; and the language in *Whipple* quoted above precludes the imposition of "dominant motivation" proof on a taxpayer. The "significant motivation" test is consonant with

Whipple, with the statute, and with the Commissioner's own regulations, whereas the "dominant motivation" test is consonant with none of them. As Judge Friendly stated, speaking for the majority in the decision of the Second Circuit Court of Appeals in *Weddle v. Commissioner*, 325 F. 2d 849, 851 (2 Cir. 1963):

> Some passages in the Tax Court's opinion, if read alone, might suggest that the court was proceeding on what we would regard as an erroneous view of the law, namely, that a taxpayer like Mrs. Weddle has the burden of proving that her 'primary' motivation was to protect the trade or business of corporate employment in order to be entitled to the deduction. That is not what is said either by the statute or by the regulations, which the Supreme Court inferentially approved in Whipple v. C.I.R., 373 U.S. 193, 204, 83 S. Ct. 1168, 10 L. Ed. 2d 288 (1963). In the law of torts, where the notion of 'proximate' causation is most frequently encountered, a cause contributing to a harm may be found 'proximate' despite the fact that it might have been 'secondary' to another contributing cause. See 2 Harper & James, The Law of Torts, §§ 20.2 and 20.3; American Law Institute, Restatement, Torts, §§ 432(2), 433, 439, 875, 879 (1939); Restatement Second Torts, § 443A at 54 (Tent. Draft No. 7, 1962, § 442B at 29 (Tent. Draft No. 9, 1963). So here, particularly in view of the backhanded wording of § 166, it suffices for deduction that the creation of the debt should have been

> significantly motivated by the taxpayer's trade or business, even though there was a non-qualifying motivation as well.

The majority of the panel in the Fifth Circuit Court of Appeals in the instant case stated: "We are impressed with the majority holding in the Second Circuit decision in *Weddle v. C.I.R.* . . . and its analogy between proximate cause and significant motivation . . . We find no error in the District Court's instruction relative to the significant motivation of taxpayer in determining the proximate relation of a debt to his trade or business." R. 173-174.

Petitioner criticizes the Second and the Fifth Circuits for not furnishing any reason why tort principles should control for federal tax purposes and emphasizes that the notion of "proximate cause" in tort cases is a conclusional term. Petitioner's Brief, page 23 *et seq.* Obviously, Judge Friendly in the Second Circuit did not adopt and incorporate the law of torts into the tax law; he referred by analogy to that law to illustrate that there may be more than one cause, as there may be more than one motivation. He specifically referred to the statute itself, and to the regulations, and by setting forth a test of "significant motivation" he obviously required a firm nexus between the debt and the taxpayer's trade or business.

Further, the test is consonant with the change in the law in the Internal Revenue Code of 1954. Under Section 23(k)(4) of the 1939 Code, the term "business debt" was defined to mean ". . . a debt the loss from

the worthlessness of which is incurred in the taxpayer's trade or business." Under the Internal Revenue Code of 1954, this definition is retained, but an additional definition is added whereby the term "business bad debt" is expanded and defined to include a debt that is "created or acquired (as the case may be) in connection with a trade or business of the taxpayer." For this additional definition to be meaningful, the "significant motivation" test of Judge Friendly in *Weddle* is the only sensible test to apply.

By setting forth the test of "significant motivation", both the Second Circuit in *Weddle* and the Fifth Circuit in the instant case require a firm nexus between the debt and the taxpayer's trade or business. The word "significant" is not susceptible of so many meanings as to cause difficulty for judges or juries. The *American College Dictionary* defines "significant" as "important; of consequence." The *Oxford English Dictionary* defines "significant" as "full of meaning or import; important, notable."

The test, therefore, is obviously one of reason and common sense; a shareholder-employee may be allowed to charge off losses as business bad debts when it is found that the loan or the execution of the indemnity agreement was essential to, or so proximately related to the business of the taxpayer that it can be said to have been made "in connection with" that business. There is no sole criterion. If the loans bear a "significant" relationship to taxpayer's business, they may qualify as business debts, even though the taxpayer has more than one motive for making the loan or

guaranteeing the debt or executing the indemnity agreement. Furthermore, the test commends itself to common sense because it recognizes that a person may have more than one motivation for an action, just as there may be more than one cause for any given effect; because it recognizes that the question whether a debt is a business or nonbusiness debt is a question of fact that may vary in each particular case; and because it sets forth a rational guideline distinguishing motivations that are important from motivations that are too indirect, too remote, or too speculative.

In this connection, it should be noted that it is not unusual for the tax status of a transaction to depend on the motivation of the taxpayer in entering the particular transaction.[5] Neither the statute nor the regulations contain any language to indicate that *only* if the motivation is the dominant motive is the taxpayer entitled to a business bad debt. Section 166 of the Internal Revenue Code of 1954 does not define "business bad debts" as only those incurred directly in a trade or business, nor does it accord business bad

---

[5] **Interestingly, the right hand of the Government apparently does not know what the left hand is doing. The Government here urges that the "dominant" motivation test is the only one that is rational, and a "significant" motivation test imposes impossible logical burdens on it. Yet in the area of "contemplation of death", when the question arises as to a decedent's motivation for making a gift during his lifetime within three years of death, the Government urges that it, the Government, should win if the death motive is "a substantial part" in making the transfer and not necessarily the "dominant" purpose. See, e.g., *Farmers' Loan & Trust Co. v. Bowers*, 98 F. 2d 794 (2 Cir. 1938); *Gordon v. United States*, 163 F. Supp. 542 (W.D. Mo. 1958).**

debt treatment only to debts which are motivated solely or predominantly by a taxpayer's trade or business. The very idea of weighing motives as if they were blocks to be placed on a scale borders on the fantastic. The Second Circuit and the Fifth Circuit have properly, it is submitted, introduced an element of reasonableness into the determination of the proximate relationship of the debt to the taxpayer's trade or business. In real life, transactions are entered into from mixed motives, and a man may be motivated for one, two, three, four or more reasons, and there may even be unconscious or subconscious motivations. In many cases, where a transaction is entered into for mixed motives, there may not be any single dominant motive. For this reason, the trial judge, the majority in *Weddle*, and the majority in the Fifth Circuit decision below,[9] were absolutely correct in using the word "significant" in referring to the motivation, since the "significant motivation" test means that the taxpayer's motive must be an important and substantial factor in entering the transaction for the relationship to be proximate.

Petitioner attempts to dismiss any reference to questions of motivation in other contexts (see fn. 11, p. 22, Petitioner's Brief), but such out-of-hand dismissal is not so easily accomplished, nor is it proper. (See fn. 5, *supra.*) For example, *United States v. The Donruss Company*, 393 U.S. 297 (1969), concerned the question whether the improper accumulation surtax on corporations "formed or availed of for the purpose of avoiding the income tax" applied to the taxpayer, and the case turned on the issue of what test is proper. This Court held that it was not proper to require

proof that tax avoidance was a *dominant*, controlling or impelling reason for accumulation of earnings, but rather that the taxpayer must establish by the preponderance of the evidence that tax avoidance with with respect to shareholders was not one of the purposes for accumulations of earnings beyond the reasonable needs of the business.

Without going into detail into the matter of the unreasonable accumulations surtax, which is a different tax from that involved in *Generes* and consequently involves a different tax statute, it is important to note that the law was designed to emphasize unreasonable accumulation as the most significant factor in the incidence of the tax. This Court noted that reasonableness of accumulation is a relatively objective inquiry and is susceptible of more effective scrutiny than are the vagaries of corporate motives. This Court dismissed the taxpayer's contention that the court should adopt a test "that requires that tax avoidance purpose need be dominant, impelling, or controlling." 393 U.S. at 307. This Court noted that adoption of such a test would exacerbate the problems that Congress was trying to avoid and then noted in language that is especially important even for the *Generes* case:

> Rarely is there one motive, or even one dominant motive, for corporate decisions. Numerous factors contribute to the action ultimately decided upon.

393 U.S. at 308.

The importance of the *Donruss* case here is that this Court, in deciding against the taxpayer, nevertheless held that to trigger the operation of the statute it was not necessary that the government prove that tax avoidance was a dominant motive, but that so long as tax avoidance was, in effect, a significant factor among the different motivations, then the improper accumulations tax would apply. What is sauce for the goose is sauce for the gander, and it would appear that if the primary or dominant motivation theory, when argued by taxpayers, is not acceptable because there is rarely one motive or even one dominant motive, so that the significant motivation test (as there urged by the government) is proper, then in the area of proving proximate relationship to a trade or business, where motivation is the crucial issue, the same reasoning should apply, and the significant motivation test should be followed. Counsel respectfully submits that the reasoning of the *Donruss* case strengthens and supports the reasoning of Respondent in the *Generes* case and supports the charges to the jury as given by the trial judge. The only difference, really, from the reasoning in the *Donruss* case is that, so far as the government is concerned, the shoe is on the other foot. In the *Donruss* case it was the taxpayer who argued in favor of the dominant or primary motivation test and the government which argued for the significant motivation test, whereas in the *Generes* case it is the taxpayer who is arguing for significant motivation and the government which argues for primary motivation.

II.

If A Significant Employee Motivation Is Sufficient To Justify Business Bad Debt Transactions, There Was Clearly Such Motivation In This Case; Even If Dominant Motivation Is The Proper Test, The Evidence Clearly Shows Such Motivation Here.

The motivation of the taxpayer in executing the indemnity agreement, that is, whether he was motivated as an investor seeking to protect his investment or as an employee seeking to protect his salary and his position as an officer of the corporation, is patently a question of fact, solely within the province of the jury. Under Rule 52(A), Federal Rules of Civil Procedure, findings of fact "shall not be set aside unless clearly erroneous."

Considering all of the evidence and all reasonable inferences of which the testimony is susceptible, the findings of fact made by the jury in this case are not "clearly erroneous" and are, in fact, eminently correct.

The testimony adduced at the trial demonstrated the proximate relationship of the execution of the indemnity agreement to the taxpayer's trade or business. There was no dispute that Allen Generes had as a trade or business working as a corporate executive for Kelly-Generes, a corporation in the construction business. There was substantial testimony (which was not disputed, much less rebutted) that in the nature of the construction business, a construction company such as Kelly-Generes cannot operate without the use

of bonding companies. (See fn. 3, *supra*). There was also substantial testimony, which was also unrebutted, that the bonding companies will not issue payment and performance bonds without the personal indemnification of the substantial officers of the corporation, here, Allen H. Generes. If Generes had refused to sign a personal indemnification agreement with the bonding company, there would have been no payment and performance bonds, and as a result, there would have been no contracts. The corporation would have gone out of business, and Allen Generes would have lost the very substantial salary of $12,000 per year. Thus, it was clearly a necessity of his trade or business as an employee that Generes agree to be personally liable in the event a bonding company had to fulfill its bonding promise.

Furthermore, it should be re-emphasized here that both William F. Kelly and Allen H. Generes had the exact same investment in the corporation, $38,900, but they drew different salaries: Kelly's was $15,000 and Generes's was $12,000 per year. Obviously, Generes's salary was very substantial in comparison with the size of the investment in the corporation.

It should be noted that the jury had before it all the relevant data regarding the size of Generes's investment in the corporation. Generes had a total of $38,900 (R. 43). The corporation grew over the years, doing nearly $13 million volume of business between 1954 and 1962 (R. 49); it owned about $1 million worth of assets at the time it was liquidated, although the equipment was heavily morgaged (R. 55, 58). (Generes

properly claimed the $38,900 investment as a capital loss when the company became defunct).

It should also be noted that the risk assumed by executing the indemnity agreement was not as excessive as Petitioner's brief implies. For the reasons stated in Respondent's "Statement of Facts", *supra*, the true risk on the indemnity bond was not large, because the $2 million line of credit merely meant that Kelly-Generes could enter into construction contracts for which the aggregate contract price was $2 million. Obviously, the contract would produce funds to pay the contractor, and Generes would be liable only if the company defaulted on the job and was then unable to pay *and* if there was insufficient retainage in the contract job, and then only for the amount ultimately uncollectible from the corporation.

Despite persistent cross-examination, Generes testified time and again that his motivation in executing the indemnity agreement was to protect his salary as opposed to his investment (R. 59, 64-69, 73-74).

The Government's brief failed to note that Judge Rubin charged the jury that among the numerous factors it could consider in determining motivation, one factor was: "What was the amount of Mr. Generes' investment in the company which he would be protecting by signing the indemnity agreement, and what was the amount of annual salary he would be protecting thereby?" See R. 122-123. From a lengthy charge which lasted over one hour and which contained over 4,500 words, the government has selected the one word

"significant" and pounced upon it in the hope of persuading this Court that the use of that word is reversible error.

Counsel respectfully submits that even if this Court determines that the dominant motivation test is the proper test, which Respondent denies, the evidence adduced at the trial on the merits clearly and convincingly demonstrates that the protection of Allen Generes's salary was, in fact, his dominant motivation in executing the indemnity agreement and that he should prevail even under that test.

Assuming, however, that this Court concurs with the Second Circuit and the Fifth Circuit that the "significant motivation" test is proper, counsel respectfully submits that it is ludicrous to argue that the issue of such proximate relationship should be withdrawn from the jury and determined solely as a matter of law.[6]

---

[6]Obviously, in virtually all cases involving the question whether a particular loss or expense is incurred in a taxpayer's trade or business, or is created or acquired in connection with a taxpayer's trade or business, the question is one of fact in each particular case. *Higgins v. Commissioner*, 312 U.S. 212 (1941).

See, for example, *Commissioner v. Moffat*, 373 F. 2d 844 (3 Cir. 1967) in which the Court of Appeals for the Third Circuit sustained a finding of the Tax Court that the taxpayer's activities as lessor of coal lands to a corporation which was controlled by the taxpayer constituted a trade or business for income tax purposes, and that evidence supported the finding that the taxpayer's guarantee of the corporation's repayment of loans, as well as payment of indebtedness arising from such loans, were "not only proximately but directly related" to that business. 373 F. 2d at 847.

See, also: *Tony Martin*, 25 T.C. 94 (1955) in which the famous singer advanced funds to a corporation in order to enable the corporation to complete a movie; the purpose of the loan was found to be, on the facts, to protect and save the singer's career and was therefore proximately related to a trade or business

CONCLUSION

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

MAX NATHAN, JR.
of
SESSIONS, FISHMAN,
ROSENSON, SNELLINGS AND
BOISFONTAINE
Counsel for Respondent
21st Floor,
Bank of New Orleans Bldg.
1010 Common Street
New Orleans, Louisiana 70112

---

of the taxpayer and he was therefore entitled to a business bad debt deduction. Parenthetically, it should be observed that the case arose under the pre-1954 Code where the relevant statute did not contain the language that the debt may be "created or acquired in connection with" the taxpayer's trade or business.

Again, in *Jaffe v. Commissioner*, T.C. Memo. 1967-215, the Tax Court accorded business bad debt treatment to two shareholders, a father and a son, who were equal owners of a corporation. They loaned money to the company in the hope of protecting their jobs, since the father's advanced age and the son's unusual personality made it doubtful that they could be employed anywhere else. Again, the Tax Court held that both parties were in the business of rendering services to the company for compensation, and they made the loans so that that business would continue and as a result their bad debt losses were business bad debts. Again, the court accorded considerable weight to the testimony of the taxpayers themselves that their loans were made and their guarantors' liability in respect of bank loans were made in order to preserve their jobs with the corporation.